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HAROLD L. KAPLAN, et al.,

Petitioners,

v.

LOUISIANA PROCESSING, et al.,

Respondents.

BRIEF FOR RESPONDENTS IN OPPOSITION
TO PETITION FOR CERTIORARI

[redacted]

INDEX

	PAGE
QUESTION PRESENTED	1
STATEMENT OF THE CASE	1
THE FACTS	2
REASONS FOR DENYING CERTIORARI	4
I. THE COURTS BELOW CORRECTLY APPLIED THE PRINCIPLES ENUNCIATED IN THE *SILVER* CASE	4
II. PETITIONERS' ATTEMPTS TO CIRCUMVENT THE PRINCIPLES OF THE *SILVER* CASE DO NOT WARRANT CERTIORARI	7
A. The Claim That Existing Rates Are Unreasonable	8
B. The Standard of "Reasonable Rates"	9
C. The Change from "Uniform" to "Reasonable" Rates	10
D. The Maloney Act Amendment	11
E. The Alleged Lack of "Pervasive" SEC Regulation	12
F. The Claimed Lack of a Remedy Except under the Antitrust Laws	13
CONCLUSION	14

TABLE OF AUTHORITIES

CASES

American Power Co. v. *S.E.C.*, 329 U.S. 90 (1946)	9
Arrow Transportation Co. v. *Southern Railway Co.*, 372 U.S. 658 (1963)	8
Board of Trade of Kansas City v. *United States*, 314 U.S. 534 (1942)	8

PAGE

Federal Power Commission v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944) 10

Montana-Dakota Co. v. *Pub. Serv. Co.*, 341 U.S. 246 (1951) 13

Silver v. *New York Stock Exchange*, 373 U.S. 341 (1963) 1, 4-7, 15

T.I.M.E., Inc. v. *United States*, 359 U.S. 464 (1959) .. 14

STATUTES

Administrative Procedure Act, 5 U.S.C. § 1001 et seq. 14

Section 4(d), 5 U.S.C. § 1003(d) 14

Section 2(g), 5 U.S.C. § 1001(g) 14

Section 10(a), 5 U.S.C. § 1009(a) 14

Communications Act of 1934, 47 U.S.C. § 201 10

Federal Aviation Act of 1958, 49 U.S.C. § 1374 10

Interstate Commerce Act, 49 U.S.C. § 1(4)(5) and 316 10

Securities Exchange Act of 1934, 15 U.S.C. 78a et seq. 1, 2

Section 6, 15 U.S.C. § 78f 3

Section 6(a)(4), 15 U.S.C. § 78f(a)(4) 3

Section 6(d), 15 U.S.C. § 78f(d) 9

Section 19(b), 15 U.S.C. § 78s(b) 3, 5, 9, 12

Section 19(b)(9), 15 U.S.C. § 78s(b) 1, 6, 7, 9, 12

Maloney Act Amendment, 15 U.S.C. § 78o-3(b)(7) .. 11

Sherman Antitrust Act, 15 U.S.C. § 1 1

PAGE

CONGRESSIONAL MATERIAL

78 *Congressional Record* 8087, 8092, 8490, 8493-94 (1934) 11

112 *Congressional Record* 17061-17063, August 2, 1966 13

Hearings Before Senate Committee on Banking and Currency on Stock Exchange Practices, 73d Cong., 2d Sess., Pt. 16, pp. 6075, 6080 (1934) 10

Hearings Before House Committee on Interstate and Foreign Commerce, H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess., pp. 320-21, 423-24 (1934) 10, 11

Hearings on S. Res. 84 Before Senate Committee on Banking and Currency, 72d Cong., 2d Sess., App. to Pts. 1-3, Ex. 24 (1932) 11

Stock Exchange Practices, Hearings Before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., Pt. 16, p. 7705 (1934) 11

Report of Special Study of the Securities Markets of the Securities and Exchange Commission, 88th Cong., 1st Sess., House Document No. 95 (1963-64) 7, 12, 13

No. 197

IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

HAROLD Z. KAPLAN, et al.,
Petitioners,

vs.

LEHMAN BROTHERS, et al.,
Respondents.

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITION FOR CERTIORARI

QUESTION PRESENTED

The question presented is whether, in view of this Court's decision in *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (1963), any reason exists for this Court to review the decision below holding that the rules of the New York Stock Exchange fixing minimum rates of commission to be charged by its members do not violate the Sherman Antitrust Act (15 U.S.C. § 1 *et seq.*) since such rules are authorized by Section 19(b)(9) of the Securities Exchange Act of 1934 (15 U.S.C. § 78a *et seq.*) and are subject to review and revision by the Securities and Exchange Commission.

STATEMENT OF THE CASE

In this civil action under the Sherman Act petitioners as shareholders sue derivatively on behalf of five investment companies ("the mutual funds") and as a class on behalf of other shareholders. Relief is sought against respondents New York Stock Exchange ("the Exchange")

and four of its member firms which, it is alleged, act with others as brokers for the mutual funds in the purchase and sale of securities listed on the Exchange.

The amended complaint (A. 3-35)[1] charges that the long established practice of the Exchange of adopting rules fixing minimum commission rates for transactions in securities listed on the Exchange constitutes an illegal price-fixing conspiracy and that the mutual funds have been damaged to the extent of the difference between the fixed commission rates charged and the lesser rates which it is asserted would have prevailed in the absence of the Exchange rules. The relief sought is treble damages, a declaratory judgment, and an injunction prohibiting the continuance of commission rate-fixing by the Exchange.

The Exchange and the member firms moved to dismiss and for summary judgment upon the ground that, since the fixing of commission rates by the Exchange is authorized by the provisions of the Securities Exchange Act of 1934 ("the Exchange Act") and is subject to oversight, review and revision by the Securities and Exchange Commission ("the SEC"), rules fixing such rates are immune from attack under the Sherman Act (A. 36-37). The District Court granted summary judgment for the Exchange and member firms (App. 1a-9a; 250 F. Supp. 562), and the judgment was affirmed by the Court of Appeals (App. 10a-11a; 371 F.2d 409).

THE FACTS

Most of the matters in petitioners' Statement of the Case are irrelevant and exceed the permissible limits set by Rule 23(1) of this Court. The only pertinent question

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1. References to (A. . .) are to the appendix filed in the Court of Appeals. References to (App. . .) are to the appendix attached to the petition.

is whether the Exchange may adopt rules fixing minimum commission rates free from antitrust liability, not whether those rates are in fact reasonable. The reasonableness of rates is a matter confided by Congress to the jurisdiction of the SEC and is not subject to collateral attack in an antitrust proceeding. The facts material here, therefore, are few and not subject to dispute.

Since its founding in 1792 the Exchange has adopted and enforced rules prescribing minimum commissions to be charged by members on transactions in securities dealt in on the Exchange (A. 21-23, 38-39). The Exchange Act, enacted in 1934, required that all national securities exchanges register with the SEC and be subject to its regulation. The Exchange applied to the SEC for registration pursuant to Section 6 of the Exchange Act and submitted copies of its Constitution and Rules, including the rules prescribing minimum commission rates then in effect (A. 39, 40). The SEC approved the Exchange's application and found that the Exchange's Constitution and Rules, including those concerning minimum commissions, "are just and adequate to insure fair dealing and to protect investors" (A. 53, 54).

Thereafter, the Exchange's minimum commission rates were revised five times—in 1938, 1942, 1947, 1953, and 1958 (partially revised in 1959). Each proposed change was recommended on the basis of a factual study and report of a Special Committee of the Exchange and was submitted to the SEC pursuant to Section 6(a)(4) of the Exchange Act for review under Section 19(b) of that Act. After such review the SEC in some instances did not require modification of the proposed changes. In other instances the SEC requested modifications in the proposed changes which were then adopted by the Exchange (A. 40-44). The commission rates established in 1958, and modified in 1959 in conformity with the request of the SEC, are presently in effect (A. 44).

REASONS FOR DENYING CERTIORARI

In *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963), this Court settled the question of the scope of the antitrust exemption accorded to a national securities exchange, registered with the SEC under the Exchange Act, with respect to actions taken by such an exchange in order to carry out its self-regulatory duty under the Exchange Act. The principles there expounded are controlling here. Consequently, this is not a case where this Court is called upon to decide "an important question of federal law which has not been, but should be, settled by this court." Furthermore, since the judgment of the Court of Appeals properly applied the rationale of *Silver*, this is not an instance where an appellate court has "decided a federal question in a way in conflict with applicable decisions of this court." (See Rule 19 of this Court).

I.

THE COURTS BELOW CORRECTLY APPLIED THE PRINCIPLES ENUNCIATED IN THE *SILVER* CASE.

The District Court and the Court of Appeals rested their determinations that the antitrust laws are inapplicable to the Exchange's rules fixing minimum commission rates on the landmark decision in *Silver*, where this Court considered for the first time the applicability of the Sherman Act to the activities of the Exchange carried on in the exercise of its duty of self-regulation under the Exchange Act. In spelling out in *Silver* the nature and extent of the Exchange's antitrust exemption, this Court was not only aware of the principles of law relating to "implied repeals" expounded in the cases cited by petitioners (petition pp. 28-31) but applied those very principles in defining the interrelationship between the Exchange Act and the antitrust laws.

In *Silver* this Court recognized that the Exchange Act established a unique system of self-regulation which placed upon the nation's registered exchanges the initial duty to promulgate rules governing their own affairs and committed to the SEC as guardian of the public interest a power of oversight and revision of those rules. The Court said that the "general dimensions" of the exchanges' "federally mandated duty of self-policing" were set forth in Section 19(b) of the Exchange Act which gave the SEC power to alter or supplement exchange rules respecting a number of specific activities of exchanges and their members (373 U.S. 352, 353). The Court pointed out that although the Exchange Act contains no express exemption from the antitrust laws and its regulatory scheme is not sufficiently pervasive to create total exemption as to all exchange activities, nevertheless repeal of the antitrust laws is to be regarded as implied where a particular instance of exchange self-regulation falls within the scope and purposes of the Exchange Act and is subject to SEC power of review and revision (373 U.S. at 357, 360-61).

The Court also recognized that to subject self-regulatory activities of the Exchange to antitrust review in areas where the SEC has supervisory jurisdiction could involve problems of "conflict or coextensiveness of coverage with the [SEC's] regulatory power" (373 U.S. at 358). It was the absence of SEC power to review the specific action of the Exchange involved in the *Silver* case (withdrawal of certain non-member private wire connections) which led this Court to conclude that in the peculiar circumstances there presented application of the antitrust laws was not incompatible with the provisions of the Exchange Act. At the same time the Court emphasized that:

> "Should review of exchange self-regulation be provided through a vehicle other than the antitrust laws,

a different case as to antitrust exemption would be presented." (373 U.S. at 360.)

Dismissal of the complaint by the District Court and affirmance by the Court of Appeals reflect the only permissible result under a proper application of both the Exchange Act and *Silver*.

Section 19(b)(9) of the Act provides:

> "The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested . . . by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as . . . (9) *the fixing of reasonable rates of commission, interest, listing, and other charges; . . .*" (Emphasis added).

Although Section 19(b)(9) is framed in terms of a grant of review power to the SEC rather than a direct grant of rule-making authority to exchanges, the provision authorizing the SEC to "alter or supplement the rules of such exchange" with respect to "the fixing of reasonable rates of commission" obviously contemplates action by the SEC with respect to rates already set by the Exchange. This is also apparent from the fact that under Section 19(b)(9) the SEC, as a prerequisite to any revision in existing rates, must first request the Exchange to "effect on *its own behalf*" any suggested "changes in *its* rules and practices." (Emphasis added).

The SEC fully supported this interpretation of Section 19(b)(9) in its brief amicus curiae urging the Court of

Appeals to affirm the District Court's judgment. The SEC's position was consistent with the "Report of Special Study of the Securities Markets of the Securities and Exchange Commission", 88th Cong., 1st Sess., House Document No. 95 (1963) (hereinafter cited as "SS"), where the respective roles of the Exchange and the SEC were explained as follows:

> ". . . the statutory scheme . . . vests rate making initiative in the exchanges and a residual, albeit continuing, responsibility of oversight in the Commission." (SS Pt. 2, p. 329).

Because the SEC is vested by Section 19(b)(9) with specific authority to review Exchange rates for reasonableness and to exercise "a general and continuing power to change, alter or supplement rules of the Exchange fixing rates of commission", the District Court properly held, and the Court of Appeals correctly affirmed, that this is the "different case" referred to by this Court in *Silver* (App. 8a; 250 F. Supp. 562, 566). Since, as the District Court said, "review is afforded within the system of securities regulation there is no need to resort to the antitrust laws for a remedy" application of the Sherman Act to Exchange commission rate-fixing would "inevitably disrupt the congressional plan" (App. 8a, 9a; 250 F. Supp. 566).

II.

PETITIONERS' ATTEMPTS TO CIRCUMVENT THE PRINCIPLES OF THE *SILVER* CASE DO NOT WARRANT CERTIORARI.

The reasons for granting the writ set forth in the petition are wholly unfounded and do not warrant consideration.

A.

The Claim That Existing Rates Are Unreasonable.

The essential weakness in petitioners' position is that it is not directed to the sole issue of whether the Exchange's fixing of commission rates is barred by the antitrust laws, but is an attack upon the economic reasonableness of the commission rate structure presently in effect, a matter which Congress has entrusted to the SEC. Petitioners assert, for example, that the minimum commission rates adopted by the Exchange are inherently unreasonable because they do not provide for graduated or volume discounts and include "costs of service other than the basic brokerage function" (petition p. 22). This argument is an invitation for an antitrust court to inject itself into the economic complexities of commission rate-fixing and to substitute its judgment for that of the SEC. Congress has seen fit to repose in the SEC the responsibility of determining whether rates adopted by the Exchange are reasonable or require change in order to effectuate and carry out the purposes of the Exchange Act. Whether the rate structure should provide for volume discounts, what the level of rates should be, and all other aspects of rate review are confided by the Act to the SEC for determination.

In comparable situations the impropriety of courts engaging in the delicate complexities of rate-fixing in regulated industries has been recognized by this Court. *Board of Trade of Kansas City* v. *United States*, 314 U.S. 534, 548 (1942); *Arrow Transportation Co.* v. *Southern Railway Co.*, 372 U.S. 658, 669-70 (1963). As the District Court in this case noted:

> "To subject the Exchange to the perils of treble liability, retroactively imposed, upon the variant decisions of different courts in determining the reason-

ableness of rates would inevitably disrupt the congressional plan designed to bring order to the marketing of securities. To leave the determination of reasonableness to the prospective decisions of the agency which is especially qualified and responsible for the general supervision of the industry will assure the intention of Congress as well as the interests of the public" (App. 9a; 250 F. Supp. at 566).

B.

The Standard of "Reasonable Rates."

Petitioners also complain that the standard of "reasonable rates" contained in Section 19(b)(9) of the Exchange Act has never been "defined" by the SEC; that the standard is "meaningless" and a "nullity"; and that it purportedly results in a "denial" of the protection of investors sought to be accomplished by the Exchange Act (petition pp. 17-20).

The standard of "reasonableness" of commission rates must be judged in light of Section 6(d) of the Exchange Act providing that an exchange may be registered under the Act by the SEC only if its rules "are just and adequate to insure fair dealing and to protect investors", and in the context of Section 19(b) authorizing the SEC to require changes in exchange rules wherever "necessary or appropriate for the protection of investors or to insure fair dealing in securities traded upon such exchange or to insure fair administration of such exchange." Thus the standard of "reasonableness" does not stand alone as a "bare bones" concept unrelated to the purposes of the Act but is fleshed out by other guidelines specified in the Act. As stated in *American Power Co.* v. *S.E.C.*, 329 U.S. 90, 104 (1946), ". . . these standards need not be tested in isolation. They derive much meaningful content from the

purpose of the Act, its factual background and the statutory context in which they appear."

Moreover, the standard of "reasonableness" has been utilized by Congress in numerous regulatory statutes as a yardstick for rate-fixing and agency review and has never been considered so bereft of substance or content as to leave the supervisory agency without adequate guidance. See, e.g., Interstate Commerce Act, 49 U.S.C. §§ 1(4), (5) and 316; Federal Aviation Act of 1958, 49 U.S.C. § 1374; Communications Act of 1934, 47 U.S.C. § 201; *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 600-601 (1944).

C.

The Change from "Uniform" to "Reasonable" Rates.

Petitioners further suggest that minimum rates cannot be regarded as "reasonable" within the meaning of the Exchange Act since during the congressional deliberations the word "reasonable" was substituted for the word "uniform" as the standard to be applied by the SEC in determining whether the rates fixed by an exchange are proper (petition p. 41). Petitioners point to nothing in the legislative history which supports these suppositions. The legislative evidence is overwhelming that Congress was well aware that the Exchange had been fixing minimum commission rates since 1792, and there is not the slightest hint that it intended to outlaw this practice. See *Hearings Before Senate Committee on Banking and Currency on Stock Exchange Practices,* 73d Cong., 2d Sess., Pt. 16, pp. 6075, 6080 (1934); *Hearings Before House Committee on Interstate and Foreign Commerce,* H.R. 7852 and H.R. 8720, 73d Cong.,

2d Sess., pp. 302-21, 423-24; *Hearings on S. Res. 84 Before Senate Committee on Banking and Currency,* 72d Cong., 2d Sess., App. to Pts. 1-3, Ex. 24 (1932); 78 *Cong. Rec.* 8087, 8092, 8490, 8493-94 (1934). On the contrary, what legislative history there is in connection with the word change in question indicates that it was designed to make clear that the SEC was to have power to order changes in the level and structure of rates and not simply to insure that rates would be uniform. See, e.g., *Stock Exchange Practices, Hearings Before the Senate Committee on Banking and Currency,* 73 Cong., 2d Sess., Pt. 16, p. 7705 (1934).

D.

The Maloney Act Amendment.

Petitioners attempt to support their position by citing the 1938 Maloney Act Amendment to the Exchange Act, providing for regulation of the over-the-counter market and prohibiting any associations of over-the-counter dealers from imposing "any schedules or fixed minimum rates of commission" (15 USC § 78o-3(b)(7)). But the very fact that commission rate-fixing was specifically prohibited in the over-the-counter market and not in the registered exchange market demonstrates that Congress intended to treat the two markets quite differently.

The lesser degree of self-regulation accorded by the Maloney Act to associations of over-the-counter dealers merely reflects Congressional recognition of the fact that in over-the-counter markets there is no central market place, such as the Exchange, with authority to regulate trading, commissions or mark-ups. The intent of Congress was to leave this situation unchanged, just as it left un-

changed the long-standing practice of the exchanges to adopt rules fixing minimum rates of commission.

E.

The Alleged Lack of "Pervasive" SEC Regulation.

Petitioners argue that lack of "pervasiveness" in the SEC's regulatory authority affects the antitrust validity of exchange action taken pursuant to Section 19(b) (petition pp. 34-38). But the fact is that the broad powers granted to the SEC in the area of commission rate fixing could hardly be more pervasive. Section 19(b)(9) authorizes the SEC to order changes in exchange rules fixing commission rates whenever such changes are found to be "necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange." Furthermore, this power extends to both the level and structure of commission rates. (SS Pt. 2, p. 294).

As for petitioners' suggestion that the SEC shares their view that its powers are unduly limited by Section 19(b) (petition p. 38), it is sufficient to note that the SEC in its brief amicus curiae to the Court of Appeals in this case emphasized not only that it had all the power necessary to regulate commission rates but also that it would be obstructed in the discharge of its duty if an antitrust court should undertake the task of determining whether commission rates are reasonable.

Nor is there merit in petitioners' alternative argument that, even if the SEC has authority to regulate commission rates, it has failed to exercise that authority. In fact, the

SEC has reviewed each of the five commission rate changes adopted by the Exchange since 1934. Furthermore, since publication of the Special Study Report in 1963 the SEC has had under active and still current consideration the varied and complex problems involved in the commission rate level and structure. These and many other developments in connection with the SEC's regulation of securities markets since publication of the Special Study Report have been reported by the SEC to the House Committee on Interstate and Foreign Commerce. See, 112 *Cong. Rec.* 17061-17063 (August 2, 1966).

F.

The Claimed Lack of a Remedy Except under the Antitrust Laws.

Finally, there is no anomaly, as petitioners urge (petition pp. 45-46), in the failure of the Exchange Act to permit investors to recover damages in the event the Exchange should fix, and the SEC should accept, unreasonable rates of commission. In *Montana-Dakota Co.* v. *Pub. Serv. Co.*, 341 U.S. 246 (1951), suit was brought for damages claimed to have resulted from the charging by a utility of unreasonably high rates contrary to the provisions of the Federal Power Act which required that such rates be "just and reasonable." Plaintiff contended that the statutory requirement of reasonable rates created a legal right to rates deemed reasonable by a court although different from those accepted by the Federal Power Commission. This Court rejected such a contention, acknowledging that its decision left plaintiff without a damage remedy. This Court said:

> "Petitioner cannot separate what Congress has joined together. It cannot litigate in a judicial forum

> its general right to a reasonable rate, ignoring the qualification that it shall be made specific only by exercise of the Commission's judgment, in which there is some considerable element of discretion. It can claim no rate as a legal right that is other than the filed rate, whether fixed or merely accepted by the Commission, and not even a court can authorize commerce in the commodity on other terms" (341 U.S. at 251).

See also, *T.I.M.E., Inc.* v. *United States,* 359 U.S. 464 (1959).

This does not mean, as petitioners contend, that they are totally without a remedy in the event they believe that the rates of commission fixed by the Exchange do not accord with the prescribed statutory standard of reasonableness. The Administrative Procedure Act[2] permits any person aggrieved by any aspect of the Exchange's commission rate structure or level to request the SEC to take action. Judicial review of the SEC's action or inaction in this regard is provided for by Section 10 of the Act (See, 5 U.S.C. §§ 1001(g), 1009).

CONCLUSION

The gist of petitioners' case is that the Exchange violated the Sherman Act by complying with the commission rate fixing provisions of the Exchange Act. The rationale of

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2. See §§ 4(d) and 10(a) of the Administrative Procedure Act, 5 U.S.C. §§ 1003(d) and 1009(a).

Silver precludes such a contention. The Petition raises no issues meriting review by this Court and should be denied.

July 24, 1967.

Respectfully submitted,

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